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## **Estonia's energy monopoly executive says firm becoming international player**

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Text of report by Estonian newspaper Eesti Päevaleht website

[Interview with Sandor Liive, CEO of Estonian national power company Eesti Energia by Villu Zirnask; place and date not given: "European Energy Industry Not Entirely Adhering to Logic of Market Economy"]

Despite large investments abroad, Sandor Liive, CEO of [Estonian national power company] Eesti Energia, is adamant that the company has focused on serving the Estonian people, proceeding from the knowledge that the European subsidies-centered energy industry does not entirely adhere to the logic of the market economy.

[Zirnask] Almost every Estonian has an opinion about Eesti Energia, about what the company is and what it should do. What are the tasks of the company in the management's view?

[Liive] Investing in the security of energy and the heating supply, the distribution network, and a shale oil plant in Estonia are our priorities. Considering all the investments made by Eesti Energia, you can see that practically all our real investments have been made in Estonia. The only exception is an electricity and heat co-production project in Valka, and even that is a project of twin cities [of Valka in Latvia and Valga in Estonia]. We have acquired oil-shale deposits outside Estonia because we have unique experience in oil-shale.

Eesti Energia works toward having a better distribution network, securing the electricity supply for the future and having a domestic liquid fuel industry, which is very profitable considering current oil prices. When we speak about the reliability of Estonia's power supply, we must keep in mind that the share of electricity is only 20% of Estonia's energy consumption. The remaining 80% is made up by liquid fuel, solid fuels, and heat, which is mostly produced from gas. Energy security does not mean just electricity.

[Zirnask] What will change for Eesti Energia in 2013 when Estonia's energy market is fully opened?

[Liive] In 2013, all private persons and companies in Estonia will have an opportunity to choose from whom to buy electricity. Another change brought about by the opening of the market is that the energy market will no longer mean just Estonia; it already happened in wholesale [when part of Estonia's energy market was opened in 2010]. The Estonian power grid is connected with the grids of other Baltic countries; our grid is also connected with those of the Nordic countries, and there will be another cable built between Estonia and Finland; also Russian electricity producers operate on our market.

On a free energy market the price will not be determined by a single producer. Wholesale electricity prices are already prices of a large region, and the wholesale market will become even more active once the retail market opens. We can even say that Eesti Energia investing or not investing in electricity production does not have a direct bearing on prices because the market is so big.

The free market means for Eesti Energia that we will make a profit if the average cost of our production portfolio is lower than the price of electricity on the free market, and we will not make a profit if it is higher. A functioning free market will guarantee that electricity is available to consumers for the best possible price at any given moment. Contrary to electricity, distribution services are and will be a natural monopoly the price of which will be regulated by the competition authority. The third component of electricity bills beside electricity and distribution services are taxes such as excise duty, renewable energy charges and value added tax. I think that an electricity market will mean clearer and more understandable prices for all market players.

[Zirnask] Will the electricity market live up to expectations? For example, energy investments will still be made with public subsidies even when there is a free market...

[Liive] The free market will very well determine which existing power plant will be operational and which will not, as well as determine the market price. Indeed, there is still no proof as to how it will motivate investors to make new investments. It would be unfair to blame it all on market mechanisms because there are other factors. For example, we do not know today the amount and price of future carbon dioxide emission quotas ...; a lot of unclear aspects hinder investment decisions, which means that electricity companies in Europe invest in new production capacity mostly if they receive subsidies, such as a wind energy subsidy or a subsidy for power and heat co-production. Countries actually facilitate energy investments in areas they see fit.

That is the reality in Europe. It is not really a market economy, but it is inevitable because of the significant effect of the European climate policy.

[Zirnask] What will be Eesti Energia's share in Estonia's energy market be about five years after the opening of the market?

[Liive] There will certainly be new players in the market. Eesti Energia's share will certainly decrease in the Estonian market because we are currently a monopoly in the retail market; so it is only natural that we will lose some of our market share. If we were not to lose our market share it would be an indication of the market not functioning.

Yet, Eesti Energia must no longer consider only Estonia our market; the whole Baltic region will be our market -- we are already selling electricity in Latvia and Lithuania. We estimate that we could have approximately a 35-percent share of the Baltic electricity market.

The wholesale market is even bigger because it encompasses the Baltic and Nordic countries; new connections between Lithuania and Poland, and Lithuania and Sweden will be built; Russian electricity producers will also operate on the market. Thus, there are a lot of electricity producers and sellers on the wholesale market, but it is unclear how many of them will start operating on the Estonian retail market in 2013. There are examples in the Nordic countries indicating that the retail market is not that attractive because the retail profit margin is small or sometimes even negative.

However, companies that are not involved in electricity production and selling in any way can have an option of selling electricity on the retail market. Those are companies with an extensive client base and experience in squaring accounts with them. Entirely new competitors may appear.

[Zirnask] For example, a mobile network operator will purchase electricity from Eesti Energia or from the wholesale market, and sell it to retail clients?

[Liive] Yes, that is right. The opening of the market will be an interesting time for both customers and market players. Customers will not only have an option to choose from whom to buy but also how to buy. Meaning for how long a period to fix the price: for a year or for three months ... Market prices are very changeable.

[Zirnask] That is the sales aspect. Speaking about production, capacities in Europe as a whole are diminishing, are they not?

[Liive] It is true that Germany made a political decision to close down its nuclear power plants; yet, Finland is building a new plant, and Lithuania and Poland have plans for new plants. A new gas-fueled power plant is under construction in Lithuania, and Latvia has plans to build a second gas-fueled power plant. We are in the final stage of building new oil-shale-fueled energy blocks in Narva [Northeast Estonia], and wind farms are under construction in Narva and Paldiski [Northeast and Northwest Estonia respectively].

So, new investments are being made in production. True, most of the investments are made under various subsidy schemes because even current free market prices are not high enough to make investments financially profitable. First, the necessary investments are large and expensive. Second, we must purchase all carbon dioxide quotas from 2013 onward while today we are required to purchase them only for export.

[Zirnask] Is the EU climate policy reasonable, if the carbon dioxide issue entails so much uncertainty?

[Liive] The EU climate policy is actually very clear: the purpose is to make carbon dioxide emission expensive. It will be forbidden to distribute quotas just like that as of 2013. There will be just a few exceptions; for example, Estonia will have the right to give away a limited amount of its quota free of charge in exchange for specific investment plans; the government is in talks with the European Commission to assign quotas to Eesti Energia for a new oil-shale-fueled power plant. This particular investment is a must from the point of view of Estonia's energy security, although it would not be cost-effective if the necessary carbon dioxide quota had to be bought at market price.

Things are unclear in this respect that no one knows the market price of carbon dioxide, for example, in 2017, but the prices of carbon dioxide and electricity are interdependent: the higher the price of carbon dioxide, the higher the price of electricity. The risk concerning the price of carbon dioxide is relatively high for Eesti Energia because our production involves the emission of lots of carbon dioxide. We do invest in renewable energy production, such as wind farms, power and heat co-production plants, and the use of biomass, but carbon dioxide still plays a major role in Eesti Energia. It is a problem we are trying to deal with by investing in production technology causing less emission of carbon dioxide.

This is exactly why we have been working on acquiring a share in a nuclear power plant. The project in Lithuania has reached a point where reactor manufacturers submitted two tenders, and soon it should be clear whether the nuclear power plant is built or not. We will certainly consider participating in the Lithuanian project if it goes forward and conditions are economically reasonable.

[Zirnask] So, the shock about events in Japan has passed at least in Lithuania?

[Liive] Lithuania and Poland have declared at a political level that they will certainly continue with their nuclear energy projects. There has been no significant development in Estonia regarding a nuclear power plant. Estonia is currently not a country with nuclear power plants, and there is no reason to expect fast developments in that area.

Eesti Energia's principal problem is carbon dioxide-intensive production; there is no sign of the European Union changing its climate policy, and, therefore, we are looking around to include in our production portfolio nuclear energy, which has little carbon dioxide intensity.

[Zirnask] To what extent can renewable energy replace nuclear energy?

[Liive] Europe as a whole needs all types of electricity production: coal, natural gas, nuclear, renewable, and, in our case, oil-shale energy. There is no type of production to solve all problems. Electricity production must be versatile; there is no reason for a country or region to keep all their eggs in one basket.

Even renewable energy has negative aspects, and, for example, the public in Estonia has increasingly been against wind farms. I think that biomass has great unused potential in Estonia. We use biomass alongside oil-shale in Balti Power Plant, but it has more potential because increasing amounts of biomass are generated in Estonia, and it is possible to

start cultivating biomass crops. Another option is offshore wind farms, but Estonia cannot afford such subsidies, which is why there must be a pan-European subsidy scheme.

[Zirnask] Many people are very critical of Eesti Energia's external projects, saying that you are taking too many risks, and you should put things in order at home etc.

[Liive] There is a certain conflict between public expectations and the reality as far as Eesti Energia is concerned. Eesti Energia is a local energy monopoly, but it has become an international power company. The conflict lies in the fact that many people still expect Eesti Energia to operate as a local monopoly and deal only with local issues. The reality is that being an important player in Estonia will not be enough when the market is opened; we must be an important player in the whole region.

As to external projects in Jordan and the United States, then those are still mainly on paper. Costs we have incurred with the projects compared with the income generated from shale oil business are small, i.e. reasonable. At the same time we have unique competence regarding oil shale, and we can be regarded as global leaders here in terms of volume, experience, and technology. It would be very bad not to use our competence; we must use it in order to benefit from it. However, we will not make any real investments in Jordan and the United States until Estonia's oil industry is at a new level.

If somebody feels that Eesti Energia makes money in Estonia to invest it abroad, then he is not right. The situation is quite the opposite: we earn most of our profit by selling electricity on the free market abroad, and then invest it mostly in Estonia. External projects are interesting, and receive more attention in the press, which may have given people the wrong impression that we invest abroad a lot.

[Zirnask] One day, when the projects proceed successfully, you will have to start investing abroad.

[Liive] Yes, but we are not planning to remain the sole owner until the projects come to an end. In Jordan, we already involved a partner, but not yet in the United States. We are planning to involve partners at the latest when the projects come to a stage requiring real investments.

[Zirnask] Still, is Eesti Energia not taking too many risks abroad? Have you considered all problems that might potentially occur in the United States?

[Liive] Every project always involves risks. It is important to observe that the balance between the risk and expected profit is reasonable. We think that the balance is reasonable in external projects of Eesti Energia. As for the US project, then we have time: we can afford to wait even longer than two or four years if obtaining environmental permits and getting other necessary documentation in order will take longer than that because Eesti Energia owns the land, and it will not disappear.

[Zirnask] Have plans to list Eesti Energia on the stock exchange been dropped altogether, or might it become topical again one day?

[Liive] It is a fact that, at some point, Eesti Energia will need additional equity capital to make planned investments in Estonia. It is for the owner, i.e. the state to decide whether it will increase the owner's equity or raise capital from elsewhere.

[Zirnask] Will external projects of Eesti Energia's have potential to be listed on the stock exchange as separate companies?

[Liive] First they will reach a stage where they need risk or strategic investors. However, listing them on the stock exchange as separate companies would be conceivable later on when they have reached the production stage.

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